

Firm Performance and the Business Environment in Malaysia: A Comparison with High-Income and Upper-Middle-Income countries

Mohammad Amin and Yew Chong Soh

Firm-level survey data on registered private firms reveal that firms in Malaysia have much lower labor productivity than their counterparts in 43 upper-middle-income and 14 high-income countries. It will be difficult for Malaysia to achieve the high-income status without a significant improvement in labor productivity of the private sector firms. The lower productivity of Malaysian firms is pervasive and holds across sectors and firm-sizes. Drivers of productivity such as outward orientation of the firms, innovation, training of workers and top manager's experience are all lagging in Malaysia compared to the high-income and upper-middle-income groups. Malaysia does outperform in terms of low regulatory burden on the firms and better quality of power supply. However, corruption and crime are worse in Malaysia than in the high-income and even upper-middle-income countries.

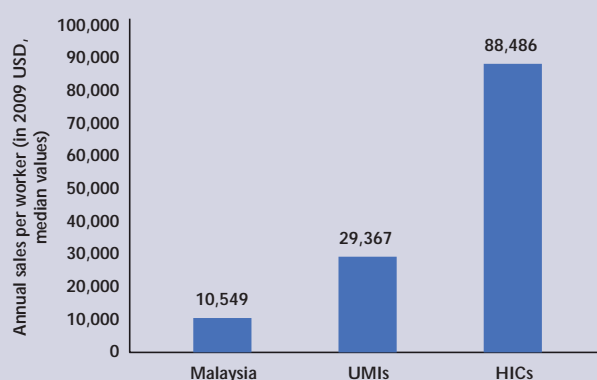
Introduction

Since its independence in 1957, Malaysia has witnessed sustained growth in income levels. The per capita GDP growth rate over this period averaged 3.8 percent per annum, higher than most economies in the world. Despite the impressive performance, there are concerns that the country may fall into a “middle-income trap”, and these concerns are amplified by the recent growth slowdown and by the experience of several middle-income countries that have failed to transition to high-income status (see for example, Larson et al. 2016, Flaaen et al. 2013). The emerging view is that productivity improvement rather than factor accumulation is the key to maintaining high growth and achieving high-income status.¹ Thus, the 11th Malaysia Plan (2016-2020) has set an ambitious target for labor productivity growth of 3.7 percent per annum compared with 2 percent per annum achieved during 2011 to 2015. The Plan envisages that raising productivity requires a comprehensive set of policies to increase human capital development, promote innovation, improve regulatory frameworks and further regional integration by liberalizing trade and investment.

In this backdrop, the performance and structure of private firms in Malaysia, and the business environment they experience, is compared with that in 14 high-income countries (HICs) and 43 upper middle-income countries (UMIs) for which comparable data are available. This is

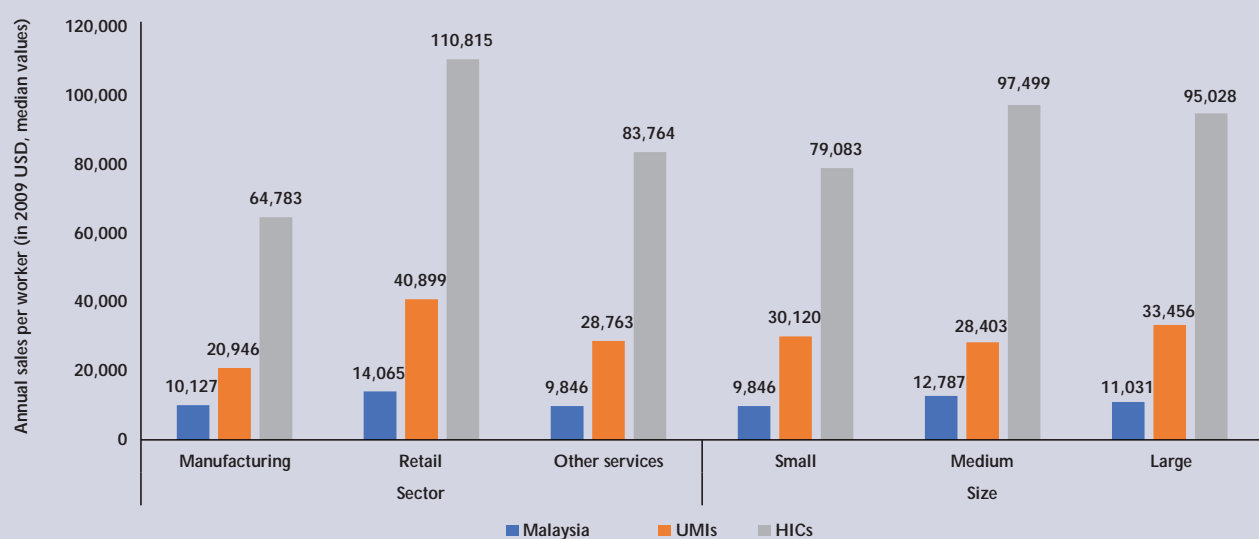
done using nationally representative surveys of private firms conducted by the World Bank's Enterprise Surveys (ES).² Unless stated otherwise, all averages discussed below for HICs and UMIs are obtained by first computing averages at the country level and then averaging across countries in the income group. Statistical significance (at the 10 percent level or less) of the differences between Malaysia and the comparators discussed is derived from firm-level regression analysis. Unless stated otherwise, all the statistical differences found persist even after taking into account other potential explanations including firm-size (workers, logs),

Figure 1 Labor productivity is much lower in Malaysia than in HICs and UMIs



Source: Enterprise Surveys (2004-2014)

Figure 2 Lower productivity of Malaysian firms vs. the comparators holds across sectors and firm-size



Source: Enterprise Surveys (2004-2014)

firms' age, industry fixed effects (2-digit ISIC Rev. 3.1), direct exports (percent of annual sales), foreign ownership (present or not), and whether the firm is part of a larger organization.

Labor productivity is much lower in Malaysia than in HICs, suggesting that the country may be stuck in the middle-income trap.

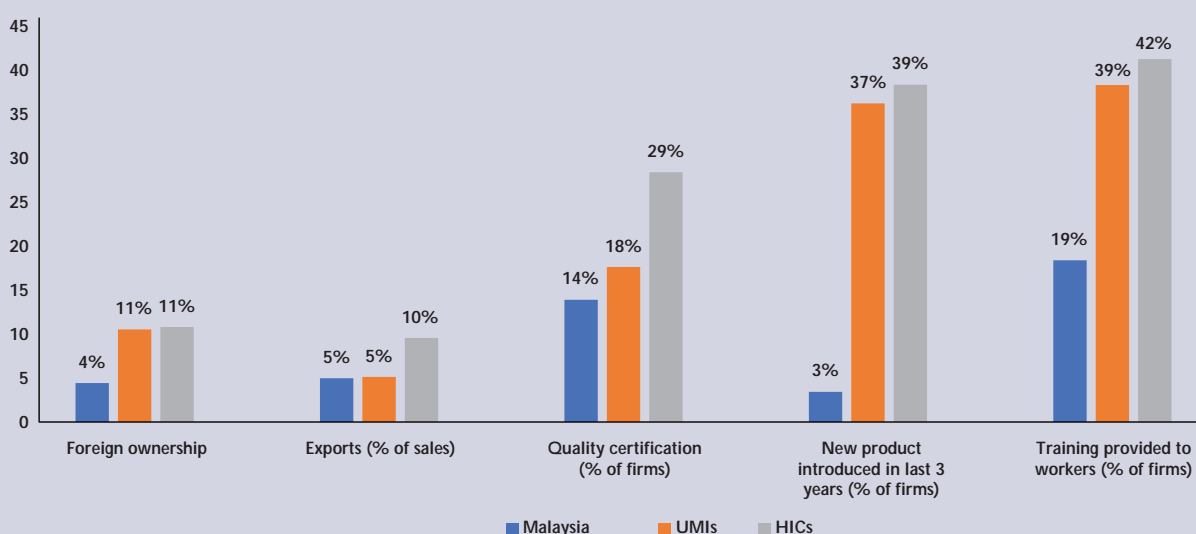
Median annual sales per worker or labor productivity is significantly lower in Malaysia than elsewhere (figure 1). It is less than 12 percent of the level in HICs and about 35 percent of the level in UMIs. The productivity gap between Malaysia and HICs may be increasing as the

annual growth rate of labor productivity over the last two years is significantly lower in Malaysia (-0.3 percent per annum) compared to HICs (1.8 percent per annum).³

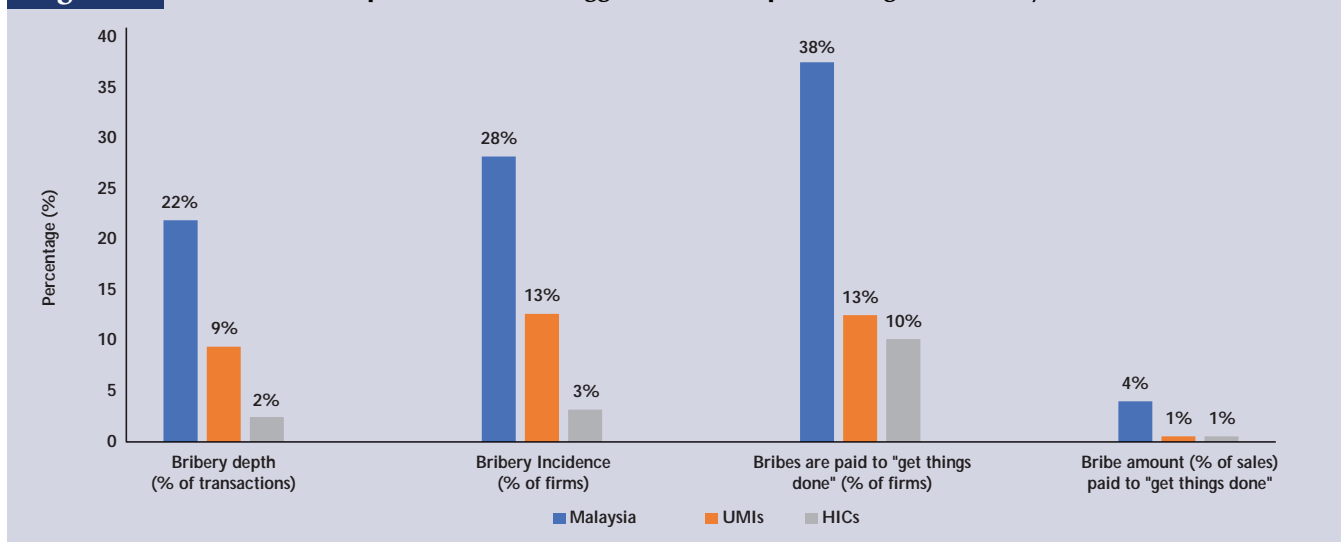
The lower labor productivity of Malaysian firms is pervasive and holds for all sectors and firm-size groups.

There is a noticeable difference in the level of labor productivity by industry and firm-size groups in Malaysia as well as the comparators (figure 2). For instance, for the case of Malaysia, median labor productivity for retail firms is higher by about 40 percent compared with manufacturing or other services firms; by size, median

Figure 3 Malaysia lags comparators in important drivers of firm productivity



Source: Enterprise Surveys (2004-2014)

Figure 4**Available corruption indicators suggest that corruption is higher in Malaysia**

Source: Enterprise Surveys (2004-2014)

labor productivity of medium firms is higher by about 30 percent of the level for small firms and 16 percent of the level for large firms. Despite these differences, Malaysia exhibits significantly lower labor productivity across all sectors and all firm-size groups compared to HICs and UMIs.⁴ Figure 2 provides the necessary details. By region, the East Coast has the highest median labor productivity in Malaysia (USD 21,191). However, even this is much lower than the average for UMIs and HICs.

Malaysia lags HICs in various factors that are known to contribute to firm productivity.

As the 11th Malaysia Plan highlights, human capital development, innovation and global integration are important drivers of firm productivity. Currently, Malaysia seems to lag HICs and even UMIs in these areas (figure 3). Regarding human capital and innovation, the ES data show that the top manager's years of experience working in the industry, the percentage of firms that provide training to their workers, the percentage of firms that introduced a new product over the last 3 years, and the percentage of firms that introduced a new product over the last 3 years that was also new to the industry are all significantly lower in Malaysia than in HICs and UMIs. In terms of the outward orientation of the firms as captured by foreign ownership (the share of firm owned by foreigners), exporting activity (exports to sales ratio) and having an internationally recognized quality certificate, it is significantly lower in Malaysia than in HICs. Malaysia also lags UMIs in these areas but not always significantly so. For instance, the percentage of the firm owned by foreigners averages a mere 1.5 percent in Malaysia, significantly lower than the 9.2 percent in HICs.

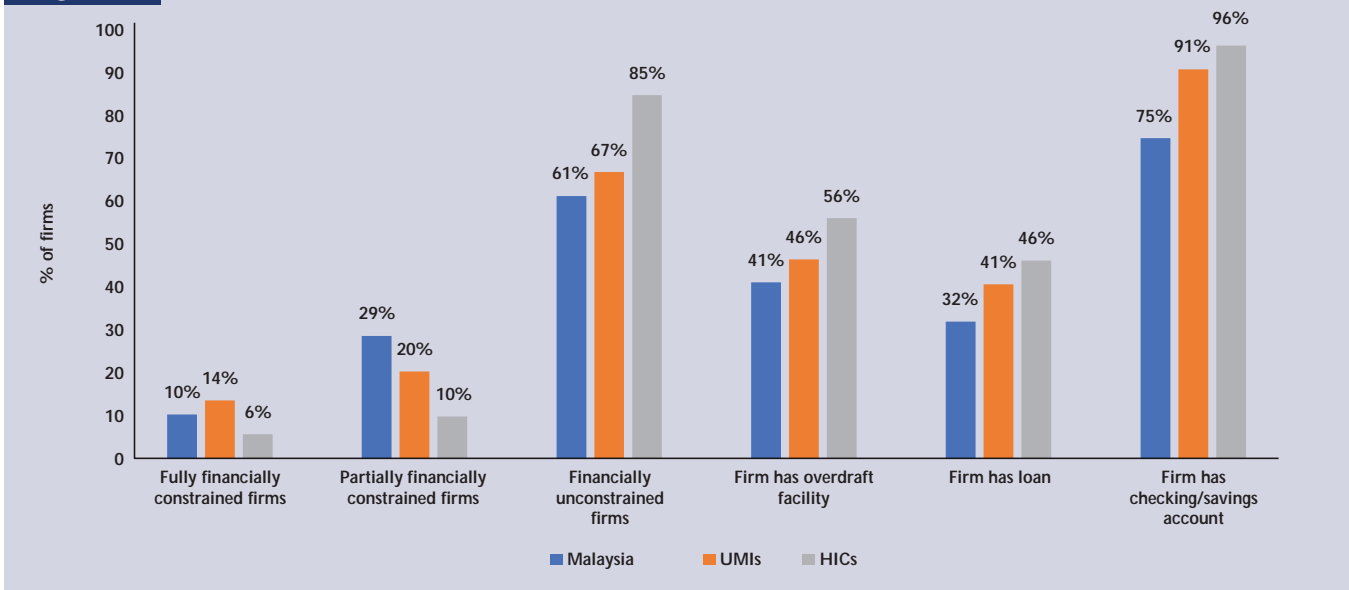
The quality of the business environment in Malaysia vs. comparators shows mixed results.

While Malaysia outperforms HICs and UMIs in certain areas including regulatory burden on the firms and the quality of power supply, it lags in other areas such as corruption, crime, and access to finance. The percentage of the senior management's time spent in dealing with government regulations ("time tax") - a broad measure of regulatory burden on the firms - averages 3.1 percent in Malaysia compared to a significantly higher 8.9 percent in UMIs and 11.4 percent in HICs. Other indicators of regulatory burden such as the proportion of firms inspected by tax officials and the number of visits or required meetings with tax officials reveal a qualitatively similar picture.

Similarly, the quality of power supply in Malaysia is impressive. A significantly smaller proportion of firms in Malaysia experienced power outages over the last year (19 percent) compared to the case in UMIs (57 percent experienced power outages) and HICs (32 percent experienced power outages). Further, a typical firm in Malaysia experienced only 0.6 hours of power outages per month over the last year, significantly lower than the 17 hours in UMIs⁵ and 1.5 hours in HICs.

Corruption is an important area of concern for Malaysia. The ES provides information on the percentage of firms that were asked for a bribe payment for one or more public transactions⁶ (Bribery incidence), the percentage of such transactions for which a bribe payment was requested from a firm (Bribery depth), percentage of firms that report firms like itself have to pay bribes to "get things done" and the amount of bribes paid (percentage of annual sales) to "get things done". All these indicators show that corruption is significantly higher in Malaysia than in HICs and UMIs. Figure 4 provides the details.

Figure 5 Malaysia lags HICs in access to finance



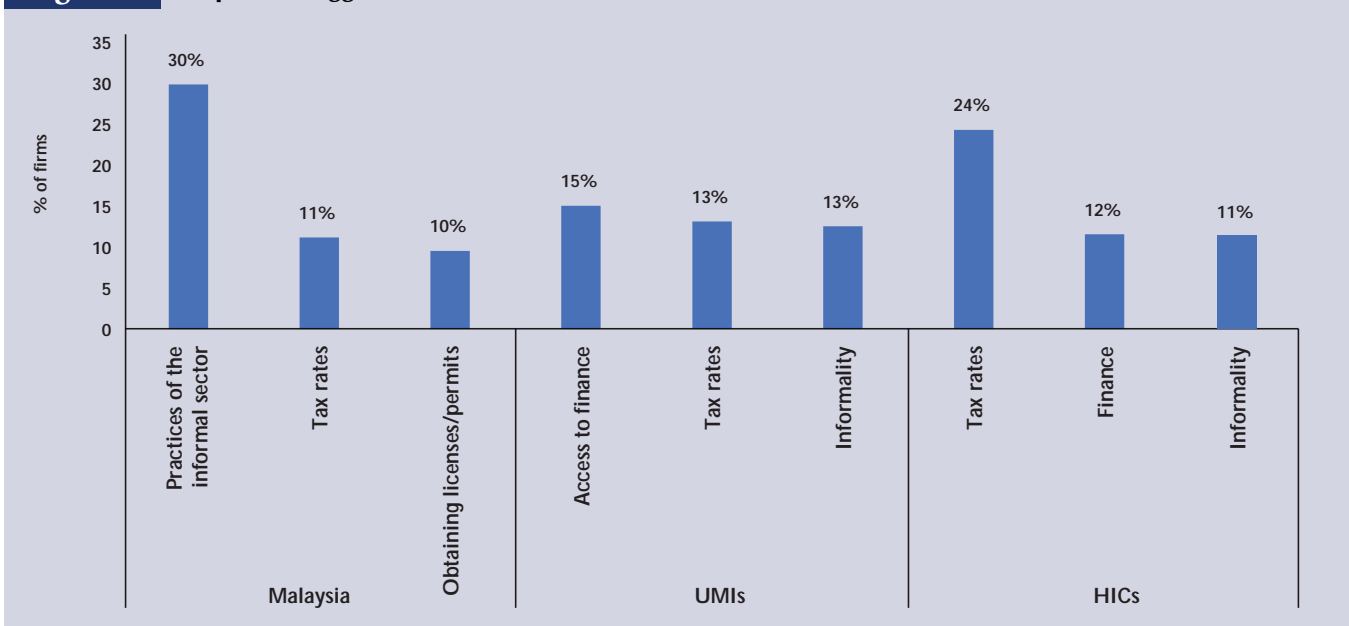
Source: Enterprise Surveys (2004-2014)

Regarding access to finance, based on information available in the ES on whether a firm applied for a loan during the last year and the reasons for not doing so if a firm did not apply, a significantly larger proportion of firms in Malaysia are credit constrained than in HICs (figure 5). There is no significant difference between Malaysia and UMI here. The ES also provides information on other measures of access to finance such as whether the firm has an overdraft facility, whether the firm has an outstanding loan or a line of credit, and whether the firm has a checking or savings account. In all these indicators, Malaysia lags the HICs and significantly so (figure 5).

Competition from informal firms is the most commonly cited biggest obstacle by Malaysian firms.

The ES asked firms about the biggest obstacle that they face in conducting their business. A list of 15 obstacles was provided to choose from. Figure 6 shows the three most commonly chosen top obstacles. Competition from informal firms is the most cited top obstacle in Malaysia. It is chosen by a significantly larger number of firms in Malaysia than in UMI and HIC. In contrast, high tax rates is the biggest obstacle for a significantly larger proportion of firms in high-income countries

Figure 6 Top three biggest obstacles (% of firms)



Source: Enterprise Surveys (2004-2015)

relative to Malaysia. The same holds for UMIs vs. Malaysia but the difference here is not significant.

Conclusion

Labor productivity of registered private firms in Malaysia is much lower than in selected high-income countries as well as upper-middle-income countries. It is highly unlikely that Malaysia can achieve its declared objective of becoming a high-income country without significantly improving its productivity. Compared to high-income countries, Malaysia enjoys lower regulatory burden on the firms and a better quality of power supply. However, Malaysia performs poorly vis-à-vis the high-income countries in terms of corruption, crime, and access to finance. Outward orientation of the firms, innovation activity, training of workers and managerial experience are some of the other determinants of productivity where Malaysia lags HICs. These and other factors responsible for the low productivity of private firms in Malaysia should be addressed through appropriate policies.

Notes

1. The literature has highlighted several factors in the context of middle-income countries and more broadly that may constrain growth. See for example, Eichengreen et al. (2013) and Aiyer et al. (2013).
2. These surveys were conducted between 2005 and 2016. Income categorization follows the World Bank. The high-income countries included are Argentina, Chile, Croatia, Czech Republic, Estonia, Hungary, Israel, Latvia, Lithuania, Poland, Slovakia, Slovenia, Sweden, and Uruguay.
3. The difference is statistically significant after controlling for the initial level of labor productivity (convergence effect) but not otherwise.
4. The difference in labor productivity here between Malaysia and UMIs for the manufacturing sector is not statistically significant unless the impact of foreign ownership on labor productivity is accounted for.
5. Average value of total hours of power outages for UMIs declines to 6 hours (from 17 hours) if we exclude Iraq and Lebanon that have unusually high levels of power outages. However, even after excluding these outlier countries, hours of power outages is significantly higher in UMIs than in Malaysia and this holds with or without controlling for the basic firm characteristics.
6. These transactions involve applying for electricity connection, water connection, construction permit, import license, operating license and in meeting with tax officials.

References

- Aiyar, Shekhar, Romain Duval, Damien Puy, Yiqun Wu, and Longmei Zhang (2013), "Growth Slowdowns and the Middle-Income Trap," IMF Working Paper 71, Washington, DC.
- Eichengreen, B., D. Park, and K. Shin (2013), "Growth Slowdowns Redux: New Evidence on the Middle-Income Trap," NBER Working Paper 18673 National Bureau of Economic Research, Cambridge, Massachusetts.
- Flaen, Aaron, Ejaz Ghani, and Saurabh Mishra (2013), "How to Avoid Middle Income Traps? Evidence from Malaysia," Policy Research Working Paper Series 6427, World Bank, Washington, DC.
- Larson, Greg, Norman Loayza, Michael Woolcock (2016), "The Middle-Income Trap: Myth or Reality?" Research & Policy Briefs, No. 1 (March), World Bank.

The Enterprise Note Series presents short research reports to encourage the exchange of ideas on business environment issues. The notes present evidence on the relationship between government policies and the ability of businesses to create wealth. The notes carry the names of the authors and should be cited accordingly. The findings, interpretations, and conclusions expressed in this note are entirely those of the authors. They do not necessarily represent the views of the International Bank for Reconstruction and Development/World Bank and its affiliated organizations, or those of the Executive Directors of the World Bank or the governments they represent.